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C O N F I D E N T I A L SECTION 01 OF 02 ISLAMABAD 002315

SIPDIS

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TAGS: EFIN ECON EINV ENRG PGOV PREL PK
SUBJECT: Pakistan Ministry of Finance explains its "fiscal discipline" to Assistant Secretary Boucher

Classified by: Ambassador Anne W. Patterson for reasons 1.4 (b) and (d)

Summary
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¶1. (C) Visiting Assistant Secretary Richard Boucher met with Pakistan Ministry of Finance Secretary Farrukh Quayyum and Special Advisor Dr. Ashfaque Hasan Khan July 2. The Minister was in Karachi for a cabinet meeting. Quayyum gave a frank overview of recent economic developments, emphasizing that the Government of Pakistan is imposing fiscal discipline to "live within its means." Acknowledging the $13 billion current account deficit, Quayyum noted that the government is trying to restart the privatization program, and looking at reaching agreement with the World Bank on the USD 500 million budget support loan to bridge the gap. He asked for renewed budget support from the U.S. and vocational skills training for the younger generation; Boucher highlighted that, while the U.S. Congress is ready to help Pakistan, direct budget support is unlikely. The Assistant Secretary also highlighted our efforts to streamline and expedite Coalition Support Funds. He added that the Administration is working on the Foreign Military Financing issue with Congress. Boucher closed the meeting by highlighting three areas where the U.S. hopes to see progress: finalizing the USD 500 million World Bank loan; working for passage of the Reconstruction Opportunity Zone legislation; and signing the bilateral investment treaty. Quayyum promised to look into reinitiating investment treaty negotiations. End summary.

Frank Economic Discussion
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¶2. (C) Assistant Secretary Richard Boucher, National Security Council Senior Director for South and Central Asia Mark Webber, Senior Advisor Caitlin Hayden, and the Ambassador met with Ministry of Finance Secretary Farrukh Quayyum and Special Advisor Dr. Ashfaque Hasan Khan July 2 for an overview of economic issues. The Minister was in Karachi attending a Cabinet meeting.

¶3. (C) After highlighting his positive experience with the U.S. both as a student and during a posting at the Pakistani Embassy in Washington, Quayyum emphasized that the current government is doing all it can to address Pakistan's economic problems. He highlighted the Prime Minister's July 1 statement that "Pakistan must live within its means" and the government's efforts at fiscal discipline in the

current budget. In the absence of stringent measures, Quayyum noted that the fiscal deficit is likely to rise to 9.5 percent of gross domestic product. Currently the fiscal deficit is running at 7 percent of gross domestic product, with a projected target of 4.7 percent for the 2008-09 fiscal year which started July 1. He also said that the government would phase out fuel and electricity subsidies, but recognized that economic growth would suffer as a result.

¶4. (C) Quayyum also discussed efforts to finance Pakistan's USD 13 billion current account deficit. He noted that thus far, the government had financed the deficit by drawing down its reserves, which had dropped from USD 16 billion in October 2007 to USD 11 billion (includes reserves in banking sector) in June 2008, but acknowledged that this drawdown was making "investors nervous." The government will resume privatization, but has not yet worked out details. He asked for U.S. budget support, and hoped to conclude the USD 500 million World Bank budget support loan negotiations soon. The government had hoped to have this loan disbursed before the June 30 end of the fiscal year but the bank continued to "move the goalposts."

Request for additional budget support
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¶5. (C) The Finance Secretary also asked for renewed U.S. budget support. Boucher explained that while the U.S. is looking at increasing assistance for Pakistan, Congress "has no appetite for budget support." On Coalition Support Fund reimbursements, Quayyum asked that the process be expedited. Boucher recognized the cash

flow problems that the reimbursement delays cause for Pakistan, and noted that this program has a USD 1.1 billion worldwide spending cap and that other countries also receive reimbursement. He added that the U.S. is trying to speed payments and wants to better define what expenses qualify for reimbursement.

Foreign Military Financing
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¶6. (C) On Foreign Military Financing, Quayyum pushed for delinking the F-16 payments with this program. He wants to tie the missed June 15 payment and the July payment, and establish an adjusted payment schedule because of Pakistan's foreign inflows shortage and current account deficit. Boucher noted that, while the Administration has been working with Congress on the possibility of using this funding for F-16 mid-life upgrades, this issue will not be resolved before the July payment is due.

Reconstruction Opportunity Zones
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¶7. (C) Quayyum characterized the Reconstruction Opportunity Zones as "the best program Pakistan could have" and that putting this legislation on a fast track will create a lot of good will. He noted that textiles have the longest value chain of all of Pakistan's exports, stretching from farm to factory, and that the sector is the biggest employer of women in Pakistan. The Assistant Secretary replied that the State Department, Office of the United States Trade Representative and White House are working on a legislative strategy for passage now that legislation has been introduced in the House and Senate.

U.S. goals
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¶8. (C) Boucher mentioned that U.S. has three short-term economic goals in Pakistan: supporting the World Bank loan once negotiations are completed; pushing for passage of the Reconstruction Opportunity Zone legislation; and conclusion of the bilateral investment treaty. He added that the investment treaty would help reverse the foreign exchange outflows, keep investment in Pakistan, and improve the investment climate. This treaty could also provide a suitable deliverable for Gilani's July 28 meeting with President Bush. Quayyum promised to examine the issue.

Request for establishment of an oil facility
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¶9. (C) At the end of the meeting, Dr. Ashfaque asked whether "anything could be done for international oil prices" and suggested establishment of an oil support fund/soft loan facility. He urged the Assistant Secretary to ask the Gulf states to establish such a facility, adding that Kuwait had given Pakistan a 60 day deferred payment plan. Boucher replied that he had encouraged the UAE and Saudi Arabia to provide short term assistance to Pakistan and other countries facing difficulties because of high oil prices.

¶10. (U) Assistant Secretary Boucher cleared on this message.

PATTERSON